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TAGS: ECON ETRD PREL EFIN PGOV UY
SUBJECT: TREASURY SECRETARY PAULSON'S VISIT TO URUGUAY JULY 11-12, 2007

REF: MONTEVIDEO 00629

Classified By: Ambassador Frank Baxter; Reasons 1.4(b),(d)

¶1. (C) Summary: Secretary Paulson's July 11-12 visit to Uruguay was viewed as a positive follow-up to the President's March visit and to Under Secretary Burns and Assistant Secretary Shannon's visits the same week. The Secretary's

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initiatives on small businesses and infrastructure finance were widely covered in the press prior to his arrival. The visit to a small business incubator underscored the message that Uruguay is an important partner in the region as a stable democracy with solid economic policies. With President Vazquez he praised Uruguay's good governance and stressed the need for capital markets. Vazquez in turn pressed for market access and certification for Uruguayan boneless lamb, which Secretary Paulson promised to pursue with the U.S.

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Agriculture Secretary. The Secretary's message on the importance of developing capital markets, however, did not appear to resonate. The meeting of Finance Ministers provided an opportunity to exchange views on economic policies, infrastructure financing and the importance of spreading the benefits of economic development. A joint press conference with the Finance Ministers from Uruguay, Mexico, and Chile highlighted their shared economic vision of bringing the benefits of economic development to broader segments of society with jobs and infrastructure. Although the overall atmosphere of the visit was extremely friendly and the Uruguayans were pleased with continued USG engagement, the fact that only like-minded countries were invited to the Finance Ministers' meeting was interpreted as an effort to counteract Venezuela. This created a backlash of criticism for Minister Astori from the more radical elements of the ruling party. End Summary.

## President Vazquez Meeting

¶2. (C) Secretary Paulson met for almost an hour with President Vazquez in the President's personal office. The

Ambassador, Acting Assistant Secretary of Treasury Clay Lowery and the PAO as notetaker attended the meeting. Vazquez thanked the Secretary for his visit, noting how important the Finance Ministers, meeting was for the GOU since "governments here have a different vision of the region and we want to meet with governments that share the same economic philosophy." He noted that in the recent MERCOSUR meeting in Paraguay, discussions with Brazil and Chile had focused on energy, support for peacekeeping efforts in Haiti, and the need to work together in multilateral organizations to coordinate macro-economic policies and consolidate economic growth. Paulson thanked the President and reiterated how the IDB can help spread the benefits of economic development to larger portions of the population through infrastructure and small business development. He reiterated his discussions with Brazilian President Lula and Foreign Minister Amorin about Doha and the need for an integrated approach to infrastructure. He also thanked Vazquez for the GOU's leadership at the WTO. Vazquez commented that the reason why the GOU was advocating for free markets in Doha was because "there needs to be a solution within Doha so that developed countries don't harm the smaller countries' ability to produce."

¶3. (C) The President agreed that the development of infrastructure is as important as energy for Uruguay's future. He cited two examples: the lack of any transportation system connecting the Atlantic with the Pacific, and the fact that to fly from Montevideo to Quito one must fly through Panama. In a May meeting with Chilean President Michelle Bachelet, Vazquez said they had agreed to provide each other mutual port access so that Uruguay may access the Pacific in Valpariso and Chile may access the Atlantic through Montevideo. This program needs concrete planning and private sector investment, Vazquez noted. Secretary Paulson encouraged the President to "come up with

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some projects that can get done." Noting that infrastructure

financing is the most time consuming and complex, Paulson expressed hope that the IDB can focus on developing a shared technology information resource so that governments can provide objective information to attract private sector to support. He urged the President to look at Chile for model projects. This would be discussed at the Finance Ministers' meeting, he said.

¶4. (C) The Secretary's second point was that the major challenge for the U.S. and the entire region is to spread the benefits of economic growth through the entire population. He pointed out that globalization has brought major changes in the capital markets and that financial capital is now less important than human capital. He also noted that the widening gap between high-low income levels is driven in the region by many factors including education, health, infrastructure, competition, technology and innovation. As a result, Paulson said, those with technology training will move far ahead. He added that in many countries he does not even make this point because these countries are so far behind where Uruguay is in developing an educated base and in implementing solid economic policies.

¶5. (C) President Vazquez confirmed that GOU's strategy is to make Uruguay a center in the region for technology innovation and research. He noted that Uruguay is the third or fourth per capita exporter of software in the world. He urged the Secretary to talk with Finance Minister Astori about the

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overall global strategy. He stressed Uruguay's efforts to attract foreign investment to sustain growth and said that Uruguay wants to be the access point into Mercosur. He noted that the GOU wants to negotiate bilateral trade agreements, but also strives to maintain regional integration. Uruguay also needs to specialize and have high quality to meet niche markets, Vazquez said, such as blueberries, rice, beef, lamb, dairy products and wine. He stressed that specializing in

quality products is how Uruguay can be efficient and set priorities. Secretary Paulson agreed, adding that, as Singapore did, Uruguay can become a location for corporate headquarters and know-how to do business in the region.

¶6. (C) Noting that he and the Ambassador came from the investment banking world, the Secretary stressed the importance of efficient capital markets with liquidity to attract foreign investment. The President pointed out that what Uruguay needed was increased investment and trade. The Secretary and the Ambassador reiterated the importance of

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robust capital markets. Vazquez did not appear to understand the importance of capital markets, however, and reiterated Uruguay's strong points for foreign investment: strong legal protections, bilateral treaties, an independent judicial system, low corruption and widespread security. Vazquez clearly did not grasp the concept and at one point stated that &I am a doctor, not an economist."

¶7. (C) Secretary Paulson then made some observations on the regional economy, noting that Uruguay is in a "tough neighborhood" with Argentina and Brazil as neighbors. He emphasized that the economic picture is generally very positive, but that governments always need to be vigilant. Turning to Venezuela, he discussed several factors that could affect the country's stability, apart from reduced oil prices, such as a major human capital flight, under investment, a much larger deficit than the publicly stated 3% deficit, and major problems in managing the economy. President Vazquez noted that Uruguay was also concerned about Venezuela and did not want to repeat what happened in Argentina in 2002 when Uruguay suffered the effects of its neighbor's crisis. "We are worried and we are aware of our vulnerabilities," he said, and "this is precisely why we have increased our primary surplus international reserves. Uruguay has had steady growth over the past 3-4 years, we paid our debt early to the IMF and in our budget we are insisting on not increasing public expenditures to control inflation. We have focused on four priorities in our budget: health, education, public infrastructure and public safety." Paulson applauded this approach as the best way to reduce

inflation by reducing public spending.

¶8. (C) At the conclusion of the meeting, the Secretary asked what he could do to help Uruguay. He noted that President Bush hopes to have Uruguayan blueberries on his cereal in the fall. Vazquez replied that hopefully President Bush would be enjoying Uruguayan lamb as well and the Secretary promised to follow up with the Agriculture Secretary on this. Vazquez mentioned that Uruguay was developing its already dynamic tourism sector into eco-tourism and had invested in security infrastructure at its airport. Ambassador Baxter noted that he planned to talk to American tourists on cruise ships to encourage them to visit the rest of Uruguay ) not just Montevideo.

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Lunch with Minister Astori
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¶9. (C) Minister Astori and his economic team (Under Secretary Mario Bergara, Director of Macroeconomic Planning Fernando Lorenzo, and Uruguay's financial representative in the US Carlos Steneri) hosted a lunch for Secretary Paulson, the Ambassador and the U.S. delegation (Acting U/S Lowery, A/S Nancy Lee, A/S Brookly McLaughlin, and Chief of Staff James Wilkenson). The Secretary reiterated the same themes concerning Uruguay's importance to the U.S., our support for increased multilateral investment and the President's interest in going as far on trade as U.S. and Uruguayan domestic environments would allow. He underscored the importance of capital markets to increase foreign investment in Uruguay. Lorenzo opined that most of the businesses were too small to issue stocks and Bergara stated that most people simply did not understand these types of investments here. (Note: The Ambassador sensed that ideology was also be a

factor in opposing capital markets, together with their lack of experience. End Note.) Minister Astori and Secretary Paulson also discussed Uruguay's economic comparative advantages, and possible growth areas. As a small open economy, Uruguay is well positioned to act as a regional financial services hub, especially for areas like back-office operations. Astori noted that financial agreements within Mercosur were impeding the integration of the regional market for financial services, and Uruguay's ability to act as a regional hub.

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Finance Ministers Meeting
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¶10. (C) The Finance Ministers meeting was attended by Chilean Finance Minister Andres Velazco, Chile's Director for International Affairs Raul Saez, Mexican Finance Minister Agustin Carstens and Mexico's Undersecretary of Finance and Public Credit Alejandro Werner, in addition to the U.S. and Uruguayan delegations. Argentina, Brazil and Colombia sent their regrets to Minister Astori's invitation and Peru failed to show at the last minute. Astori opened by thanking Paulson for selecting Uruguay to host the meeting and highlighted the significance of the event for Uruguay,s international standing. "There is no development strategy without a good international insertion strategy," he noted. The Secretary gave an overview of the global economic picture and the impact on the region. Although the U.S. economy has slowed, he was optimistic overall, given the diversification, strong consumers and labor markets and good growth outside the U.S., as well as the low inflation figures. He noted that developing countries were growing about twice as fast as industrial counties with controls on inflation, sound fiscal policies, and primary surpluses. The global economy is strong, Paulson said, and keeping inflation under control is a key element to continued expansion. He discussed the two major risks: a global financial shock and protectionism. He regarded a shock as less likely given the high level of integration among more efficient and liquid economies. He warned that countries had nevertheless to be vigilant and that the best defense was liquidity. He noted that despite evidence that countries pursuing market economies have benefited the most, protectionism has grown over the past

several years, as the good economy has reduced pressure for change. The region's number one challenge, Paulson stressed, is to spread the benefits of economic development from the top one percent of the population. For this, fostering small and medium enterprises, implementing new lending policies and developing infrastructure are key. Carstens, Velazco and Paulson exchanged ideas on the potential end of the high-liquidity era which, according to Carstens, "is generating a bonanza type of environment" that makes him "very nervous."

¶11. (C) Mexico,s Carstens talked about the role of multilateral development banks in middle income countries. In an assessment that was shared by several participants, he stated that the IFIs have been shrinking in their capacity to interact and lend to middle income countries that are accessing financial markets in better conditions. As such, IFI's credit products are no longer their best options. He suggested a number of product innovations for IFIs including financing in local currency, offering credit enhancements supporting infrastructure development and providing insurance against climate change and catastrophic risk. IFIs need to focus on those strategic sectors where they are a good complement to private sector resources and need to develop new schemes for technical assistance through lending programs that detach value-added cost from financing costs. Finally, he called on Latin American countries to play a more active role as shareholders, instead of acting as borrowers. Minister Astori agreed with Mexico's conclusions and noted that Uruguay is working with the Andean Development Bank to develop key projects. Bergara added that the costs of market development are not taken into account. He reiterated that the key is to make the banks more competitive and focus on specific priority projects. Reforms are necessary. He noted

that when Uruguay wanted to repay its debt early, the Fund said "take your time."

¶12. (C) Chile's Velasco presented ideas for promoting innovation in the region. He drew a link between research and development and productivity growth and economic growth. Latin America is still ranked middle in several important indicators like access to higher education, number of technology students, red tape to open and close businesses and research and development. He suggested an expansion of research to foster more applied research and use public monies to hook private funding. He advocated that at least 3% of GDP be invested in R&D. Minister Astori adhered totally to Velasco,s approach and emphasized the similarities between Chile and Uruguay. During the meeting he said repeatedly that Uruguay and Chile look "dangerously" alike. Astori also pointed out that Uruguay had created a five-minister board to work on innovation. Secretary Paulson noted that the key was to link research to innovation and that the enemy of innovation is all too often the public sector which is vulnerable to corruption. Countries need a Silicon Valley with private business innovation and investment. He cited Latin America as an example of excessive regulation; regulations have to be transparent. "Innovation does not come from the government, it comes from private industry; governments need to let businesses innovate,", Paulson said. Cartens added that the challenge in Latin America is the quality of government spending, and that evaluation methods are needed to ensure that people are actually being better educated with the additional dollars spent on education. Paulson agreed wholeheartedly, saying that "innovation is not how to get more public education but how to get the skills that will make people useful in the 21st century."

¶13. (C) In the final half-hour, IFC's Director of Operational Strategy Department Bernard Sheahan and Richard Frank of Darby Overseas Investments talked about infrastructure financing in the region. They also commented on the banks' pool of information and experiences that governments could provide to the private sector to facilitate private investments. Participants agreed that foreign investments in infrastructure are largely successful but also

politically very unpopular. One suggestion was to recycle investments from national retirement and pension investments to broaden a sense of ownership of national infrastructure among the population. Chile has done this with success and offers excellent models, and Brazil is just beginning.

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Small Business Incubator
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¶14. (C) The Secretary, Mrs. Paulson and the Ambassador then visited Ingenio, a business incubator for Information and Communication Technology (ICT) created as a joint initiative by the Uruguayan Technology Laboratory (LATU) and ORT University with financial support from the IADB. After a roundtable with LATU President Miguel Brechner, Ingenio Director German Martinez and six different firms discussing technology in education, teleworking, the development of capital markets and access to financing, the delegation briefly toured the facility. Among several firms visited was the Ceibal Project for President Vazquez' one-laptop per child initiative.

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Public reaction: Generally positive
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¶15. (C) The message that Uruguay plays an important role in the region as a stable democracy with solid economic policies was well-received and public reaction to the visit was generally positive with broad coverage before, during and after the visit. Although hosting the Finance Minister's meeting was generally regarded as a coup for Uruguay, there was continued editorial speculation as to who (Minister Astori or Secretary Paulson) had invited the Finance Ministers, given the notable absence of Bolivia, Ecuador and

Venezuela. The meeting was widely viewed as an attempt to unify opposition to Chavez in the region. Editorials questioned why Astori had rejected Venezuela's Bank of the South proposal at the same time he embraced Secretary Paulson's promise of $200 million in multilateral investment. Nevertheless, even notoriously anti-U.S. Foreign Minister Gargano welcomed the visit as an opportunity to press for more Uruguayan exports to its second largest customer. The Secretary's media roundtable (a transcript of this roundtable

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can be found on the unclassified system at: http://uruguay.usembassy.gov/usaweb/2007/07-3 93En.shtml) and press conference following the Ministers' meeting had prominent and sustained coverage in all national and regional radio, TV and print media.

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Comment: Radicals Backlash Against Astori
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¶16. (C) Secretary Paulson's July 11-12 visit to Uruguay was widely viewed as a positive follow-up to the visit of President Bush last March and a sign of U.S. concrete engagement in the region. In the aftermath of the Secretary's visit, however, and after a visit to Argentina on July 18, where he expressed concerns about Venezuela's entry into Mercosur, Minister Astori has been caught up in a storm of criticism emanating from the more radical elements of the Frente Amplio. His comments resulted in a sharp rebuke from FM Gargano and Communist Senator Lorier and others in the Frente Amplio called on Astori to explain why Venezuela, Bolivia and Ecuador had not been invited to the Finance Ministers' meeting. This has continued to generate headlines in the press. In answer to mounting criticism, Astori recognized that the U.S. Treasury had suggested the countries to be invited, but that the invitations had been approved by the President Vazquez. The Communist Party blasted Astori's response as "a clear admission that the invitations were issued at the behest of the U.S." The controversy opened up a new battlefront for Astori, who was already the focus of much criticism lately for his new tax reform and his firm stand against Venezuela's Banco del Sur proposal. End Comment.

U.S. Treasury Office of Western Hemisphere Affairs cleared on this message.

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